

The Effect of Petroleum Profit Tax on the Profitability of Listed Oil and Gas Companies in Nigeria

D. O. GBEGI Ph.D.

Department of Accounting and Finance
University of Agriculture
Makurdi, Nigeria

J. F. ADEBISI Ph.D.

Director General
Nigerian College of Accountancy
Kwall, Jos., Nigeria

BODUNDE Tosin

Department of Accounting
University of Jos,
Jos, Nigeria

Abstract

This study examines the effect of petroleum profit tax (PPT) on Profitability of oil and gas firms in Nigeria, in line with the objectives of this study, secondary data were obtained from financial statement of ten (10) selected oil and gas firm covering the period of 2011 to 2015. Panel data was deployed and both descriptive statistics and multiple regressions technique employed to establish the effect of PPT rate on Profitability oil and gas firms. Petroleum profit tax was found to have significant effects on the Profitability of oil and gas firms with the Adjusted R^2 of 95%. The study revealed that taxes paid by oil and gas industries have a downward effect on profitability of oil and gas industries. Following the outcome of this study, it is therefore concluded that higher tax rate cause reduction in Profitability of oil and gas firms in Nigeria for the period 2011 to 2015. It is recommended that Government should reduce the tax rate to enable oil and gas firms strive especially during this economic recession.

Keywords: Petroleum, Tax, Profit, Oil and Gas, profitability and Listed companies.

Background to the study

This study takes a brief overview of the effect of petroleum profit tax on the profitability of oil and gas industry in Nigeria with focus on some listed oil and gas industries, taxes paid by oil and gas industries was compared with profit realized by this oil and gas industries, and it effect is determined thereafter. Mintz (2010) explains that industries tax for oil and gas concerns is imposed on the incomes made from the sale of oil and gas net of the production costs which comprise current mining costs, capital cost allowances, as well as exploration and development costs. Exploration costs are expensed while development costs are capitalized and written off at the declining balance rate. Though tax is a major source of revenue to government in generating additional revenue needed in discharging its pressing obligations, tax system offers itself as one of the most effective means of mobilizing a nation's internal resources and it lends itself to creating an environment conducive to the promotion of oil and gas firms in Nigeria (Attama 2004). Oil is the dominant source of government revenue, accounting for about 90 percent of total exports, and this approximates to 80% of total government revenues. Since the oil discoveries in the early 1970s, oil has become the dominant factor in Nigeria's economy. The problem of low economic performance of Nigeria cannot be attributed solely to instability of earnings from the oil sector, but as a result of failure by government to utilize productively the financial windfall from the export of crude oil from the mid - 1970s to develop other sectors of the economy.

(Oduola, 2006) The Nigerian petroleum industry has been described as the largest among all industries in the country. This is probably due to the belief that petroleum is one of the major sources of energy worldwide. The size, international characteristic, and role assumed by the petroleum industry were noted to have originated from the notion that petroleum is versatile as it currently satisfies a wide variety of energy and related needs. Petroleum is the most vital source of energy, providing over 50 percent of all commercial energy consumption in the world (Adekanola 2007). The revenues obtained from crude oil in Nigeria are of absolute advantage to expenditure commitments on various projects at the local, state, and federal levels. The Profitability of oil and gas firms in Nigeria relies heavily on the revenue derived from petroleum products and lower tax rate, as they provide 70 percent of government revenue and about 95 percent of foreign exchange earnings. Apart from this, Azaike and Shagari (2007) opines that the contribution of petroleum to national development is many and varied; employment generation, foreign exchange earnings, income generation, industrialization, and improvements in other economic variables. While the major investors in the petroleum industry are the international oil companies (IOCs), the principal legislation governing petroleum operations in Nigeria is the Petroleum Profit Tax Act (PPTA) of 2007. Its main fiscal instrument is the Petroleum Profit Tax (PPT). Under the PPT, the tax rate was set at 67.5 percent for the first five years of operations by the oil industries and 85 percent thereafter (Onyemaechi 2012).

According to Bawa and Mohammed (2007), the Petroleum Industry is the largest and main generator of taxation in Nigeria which is the most populous in African nations. Since the British discovered oil in the Niger Delta in the late 1950s; the oil industry has become the main stay of the oil and gas firms in Nigeria. This was however not the case prior to the 1950s. Available literature on the Nigeria's Economy has it that Nigeria was primarily an agrarian economy, whose revenue generation was based on agriculture. Statistics from the Federal Bureau of Statistics indicates that between 1958-1969, the contribution of agriculture at current factor cost was 52 percent while that of oil was just 0.007 percent. Agriculture formed the main stay of the country's economy accounting for higher percentage of Profits of the firm (Anyanwu, 1993). It is against this background the research is carried out to examine the effect of petroleum profit tax on profitability of listed oil and gas industries in Nigeria.

Statement of the Problem

According to Appah and Ebiringa (2012), it is obvious from the judgment articulated in theories that petroleum profit tax can cause an increase or a decrease in Profitability of oil and gas firms in Nigeria. Not given adequate considering to the high rate of tax (85%) imposed on oil and gas firms in Nigeria will definitely reduced their earnings and in return reduce the wealth of the investors.

The objectives of this study

The main objective of this study is to examine the effect of petroleum profit tax (PPT) on Profitability of oil and gas firms in Nigeria. The specific objectives are to:

- (i) Examine the effect of PPT rate on profitability of oil and gas industries in Nigeria
- (ii) Examine the effect of PPT rate on shareholders wealth in Nigeria

Statement of Hypotheses

The following hypotheses were developed in line with the problem stated above and expressed in Null form as follows:

- H_{01} : Petroleum profit tax rate does not have significant effect on profitability of oil and gas industries
 H_{02} : Petroleum profit tax rate does not have significant effect on shareholders' wealth.

Literature Reviews Petroleum Profit Tax In Nigeria

According to Oduola (2006), petroleum profit tax (PPT) is a tax applicable to upstream operations in the oil industry. It is particularly related to rents, royalties, margins and profit sharing elements associated with oil mining, prospecting and exploration leases. It is the most important tax in Nigeria in terms of its share of total revenue contributing 95 and 70 percent of foreign exchange earnings and government revenue, respectively.

Petroleum operation as defined in the PPTA essentially involves petroleum exploration, development, production and sale of crude oil. The Petroleum Profit Tax is regulated by the Petroleum Profit Tax Act of 1959 as amended by the Petroleum Profit Tax Act of 2007. Although the initial law was passed in 1959 to capture the first oil export made in that year (Nwadighoha, 2007).

Section 8 of Petroleum Profit Tax Act (PPTA) states that every industry engaged in petroleum operations is under an obligation to render return, together with properly annual audited accounts and computations, within a specified time after the end of its accounting period. Petroleum profit tax involves the charging of tax on the incomes accruing from petroleum operations (Nwezeaku 2005). He noted that the importance of petroleum to the Profitability of oil and gas firms in Nigeria gave rise to the enactment of a different law regulating the taxation of incomes from petroleum operations. The petroleum profit tax is charged, assessed and payable upon the profits of each accounting period of any industries engaged in petroleum operations during any such accounting period, usually one year (January to December) (Anyanwu (1993). The profits of a industries in relation to the accounting period is the aggregate of:

- (a) the proceeds of sale of all chargeable oil during that period;
- (b) the value of all chargeable oil disposed of in that period;
- (c) the value of all chargeable natural gas in that period; and

all income of the industries of that period incidental to and arising from any one or more of its petroleum operations (i.e. winning or obtaining and transportation of petroleum or chargeable oil in Nigeria by or on behalf of a industries, for its own account by any drilling, mining, extracting or other like operations or process, not including refining at a refinery, in course of a business carried on by the industries engaged in such operations, and all other operations, incidental there to and any sale of or disposal of chargeable oil by or on behalf of the industries. Oremade (2006) indicated that for petroleum profit tax purposes, crude oil sales valued at the prices actually realized by the oil producing industries in the world oil market. On the other hand, this value has to be compared with the value at the posted price and if the posted price is higher, tax is then based on the posted price. Sales of crude oil for local refining and sales of gas are valued for petroleum profit tax purposes at the actual amount realized on sale. According Ofe, Onyemachi and Caroline (2008), the administration of PPTA is under the care and management of the Federal Board of Inland Revenue. The tax laws according to Adekanola (2007) have vested the authority to assess, administer and collect all taxes from corporate entities on the Federal Inland Revenue Services. Taxes administered at the Federal level include the Petroleum Profits Tax, Companies Income Tax, and the Value Added Tax as well as the Capital Gain Tax, when such capital gains are generated by corporate entities. The administration of taxes in Nigeria has also been focused on revenue generation to the detriment of stimulating economic development.

Ofe et al (2008) brought out further that the Board may do all acts as may be deemed necessary and expedient for the assessment and collection of the tax and shall account for all amounts so collected in a manner to be prescribed to the Federal Minister of Finance. Whenever the Board shall consider it necessary with respect to any tax due, it may acquire, hold and dispose of any tax or of any judgment debt due in respect of any tax and shall account for any such property and the proceeds of sale thereof in a manner to be prescribed by the Minister. The Board may sue and send be sued in its official name. In the exercise of the powers and duties conferred upon it, the Board shall be subject to the authority, direction and control of the Minister of Finance. Any written direction, order or instruction given by the Minister after consultation with the chairman of the Board shall be carried out by the Board. However, the Minister shall not give any such direction in respect of any particular industries which would have the effect of requiring the Board to increase or decrease any assessment made or to be imposed upon or any relief given tax, penalty or judgment debt due by such industries or hich would have the effect of altering the normal course of any proceeds, whether civil or criminal, relating either to the recovery of any tax or penalty or to any offence relating to the tax. Any Act, matter or thing done by or with the authority of the Board in pursuance of the provisions of PPTA shall not be subject to challenge on the ground that such was not or was not period to be in accordance with any direction, order or instruction given by the Minister (Ofe et al 2008). Oil companies that only market petroleum products including companies engaged in refining of crude oil such as petrol do not fall into the category of companies engaging in petroleum operations and they are therefore taxable under CITA. Where a industries is involved in both petroleum operation and marketing of petroleum product, the trading results from the petroleum operations would be subject to Petroleum Profits Tax while the results from the marketing activities will be taxed under the Companies Income Tax Act. All reference to companies in this unit relates to companies engaged in petroleum operation except where otherwise stated.

Assessment of Petroleum Profit Tax on Profitability of Oil and Gas Firms in Nigeria

Odusola (2006) said that the current tax system failed to take into account individual features of oil production projects, such as geology, geographical location, expenditure on development, and limits implementation of new technologies. He said: "The need to re-assess the tax system in order to provide more room for technological advancement in the industry and the country as a whole becomes more paramount. "A possibility is the concept of the excess profit tax using the financial results of the industries activities as the principal subject of taxation." The analyst maintained that setting the tax system aright will create new economic stimuli for implementation of oil production projects. He said: "One notable effort under the proposed Petroleum Industry Bill is a proposition for a total repeal of the petroleum profit tax Act, Cap P. 13, 2004. The present petroleum profit tax will be replaced with the Nigerian Hydrocarbon Tax (NHT). "Section 313 of the proposed bill provides that Nigerian Hydrocarbon Tax will be computed on the chargeable profits for the relevant accounting period at 50 per cent for onshore and shallow waters. The anticipation for the adoption of this bill into law is the optimism that it will bring about the much desired development in the sector." The analyst projected a positive outlook for the petroleum industry based on that the competitive landscape that will continue to remain appealing to operators and new market entrants. They, however, emphasized the need for the government to place emphasis on diversification of the economy to reduce dependence on oil. Continuing, they said: "Since new investments in the sector have been hampered by uncertainties around the PIB which was first initiated in 2008, the onus is on the government to palliate the growing disinterest of foreign investments. "The PIB in itself will need to be adjusted to consider the changes in global economics on oil prices and investment costs that affected almost every 170 million persons over the last six months. "Nigeria will need to join the long train of high-tech energy industry transition that has changed the business model of the sector and led to the possible development of a wide range of unconventional resources. "Considering the success story of the shale gas revolution in the US with a significant growth in drilling activities over the last few years and the skills gap in this operation, Nigeria needs to stay competitive by evaluating our position in the industry."

Gaps to be filled

No study has considered the area of focus for this study which is the effect of taxation on the profitability of oil and gas firms in Nigeria, most study concentrated on the economy but this study focused on the oil and gas firms who are paying such hung amount of their income as tax.

Methodology

This study employed inferential research design, the population of this study consisted of ten (10) largest oil and gas firms as listed by joblanda (2015). This ten (10) oil and gas firms was selected because it represent oil and gas firms that is contributing immensely to tax payable to the federal government. Data for the ten (10) oil and gas firms was gathered as this number is too outrageous for research purposes.

Method of data collection

Method employed in Carrying out this research work was by secondary data. Secondary data is the name given to data that has been used for some purpose other than that for which they were originally collected. Secondary data generally used when the term manpower resources necessary for survey are not available and of course the relevant information required. Secondary data were gotten from different sources e.g. financial statement of the oil and gas firm and Federal Inland Revenue service Bulletin.

Sample size

The duration of my research was basically from 2011 - 2015 which is in the range of 5yrs. This duration was considered because it is detailed enough to give a good result and analysis. This study employs annual data on the rate of petroleum profit tax (PPT), and Profitability of oil and gas firms in Nigeria (proxied by Profits of the firms) for Nigeria over the period 2011 to 2015. Data were obtained from the CBN Statistical Bulletin.

Data analysis techniques

Analytical techniques employed include: graphs, percentage, and Regression model using Econometric View (E-View).

Presentation and analysis of data

Table 1, List of Oil and Gas Firms

| Billion Naira | | | | | | | |
|---------------|-------------------|--------|--------|-------|----------------------------------|-----------------------------------|---------------------------------------|
| SN | Companies | PBT | TAX | PAT | Shareholders wealth (Net of Tax) | Shareholders wealth (without Tax) | Reduction in Shareholders' wealth (%) |
| 1 | Exxon Mobil | 140.14 | 119.12 | 21.02 | 400.40 | 421.42 | 0.05 |
| 2 | Chevron | 114.17 | 97.04 | 17.13 | 253.71 | 270.83 | 0.07 |
| 3 | Shell | 127.86 | 108.68 | 19.18 | 213.10 | 232.28 | 0.09 |
| 4 | Statoil | 85.53 | 72.70 | 12.83 | 155.50 | 168.33 | 0.08 |
| 5 | Total | 68.51 | 58.24 | 10.28 | 120.20 | 130.48 | 0.09 |
| 6 | Conoco Philips | 56.00 | 47.60 | 8.40 | 95.00 | 108.40 | 0.08 |
| 7 | Petrobras | 35.77 | 30.40 | 5.37 | 73.00 | 78.37 | 0.07 |
| 8 | Nexen Inc | 0.15 | 0.13 | 0.02 | 0.33 | 0.36 | 0.07 |
| 9 | Hardy Oil and Gas | 0.24 | 0.20 | 0.04 | 0.68 | 0.71 | 0.05 |
| 10 | Addax Petroleum | 0.08 | 0.07 | 0.01 | 0.18 | 0.19 | 0.07 |

Source (Joblander 2016).

Presented in table 1 are list of oil and gas firms that was considered for this study. Profit, taxes, and shareholders wealth were parameters for analysis.

Figure 1: Reduction in Shareholders' wealth (%)

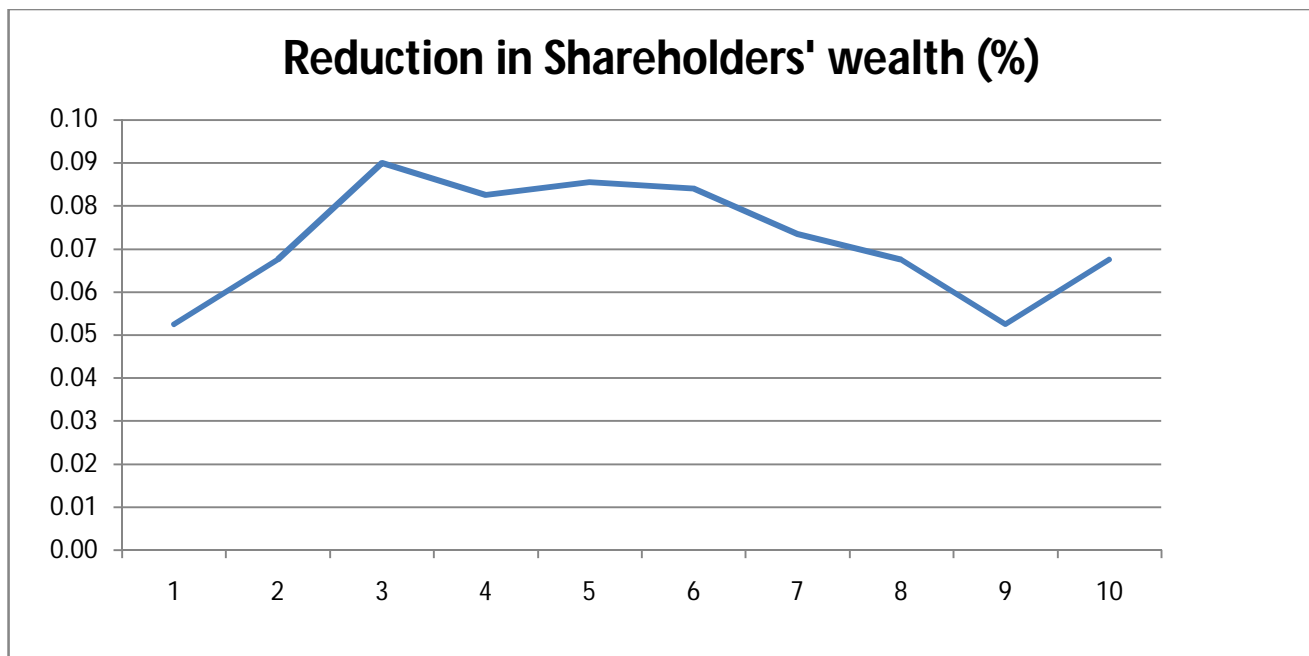


Figure 1 revealed that there has been downward movement in shareholders wealth due to excessive tax rates placed on oil and gas industries in Nigeria. The result implies that, peculiarities exist among oil and gas industries and shouldn't be placed on the same rate of 85% as PPT.

Figure 1 further revealed that due to excessive tax rate of 85% of profits that should be distributed to investors now paid as tax, not only will the profit of oil and gas firm reduced, but will also result into reduction in shareholders' wealth which is the main reason for the existence of any listed companies.

Figure 2, Compares of Profit Before and After Tax of Oil and Gas firms

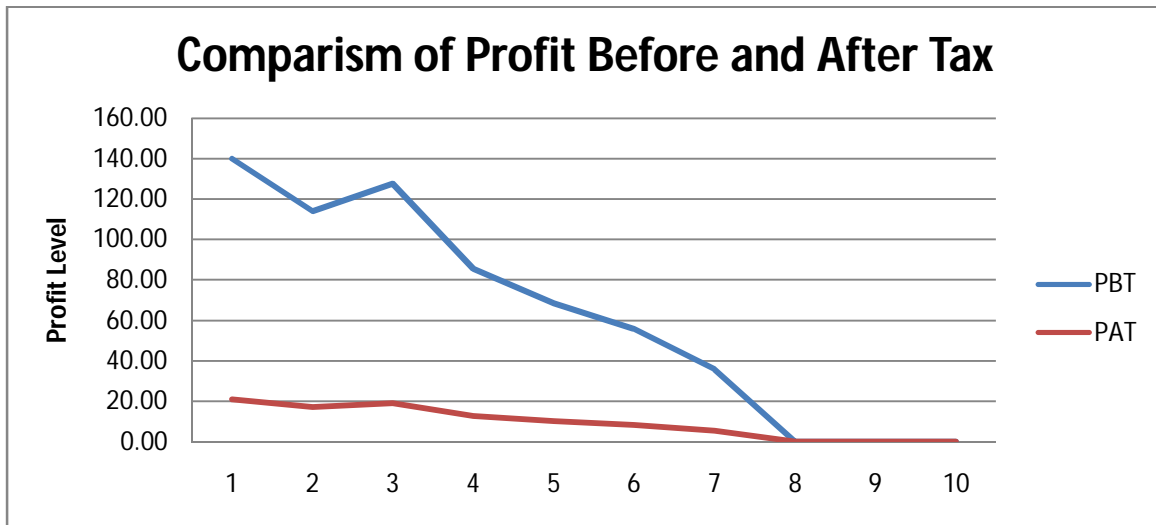


Figure 2 clearly revealed the gap between profit level before and after tax. The graph further revealed that the gap will naturally exist in the oil and gas industry because the organization would have met some certain obligation towards their growth with such amount paid as taxes to government. It might be necessary to quickly state that this publication is not against the payment of taxes but of the opinion that it should be reviewed and probably brought low. It can also be depicted from the graph that petroleum profit tax is having a downward effect on profit level of oil and gas firm.

Table 2, Effects of PPT on Profitability of Oil and Gas Firms in Nigeria

Dependent Variable: PPT
 Method: Least Squares
 Date: 10/19/16 Time: 01:19
 Sample: 1 10
 Included observations: 10

| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|--------------------------|-------------|--------------------|-------------|----------|
| C | -1.35E-14 | 1.16E-14 | -1.165920 | 0.2818 |
| TAX | 0.176471 | 5.22E-16 | 3.38E+14 | 0.0000 |
| Shareholders_Wealth__Net | -4.82e-16 | 1.84e-16 | -2.619595 | 0.0344 |
| R-squared | .950000 | Mean dependent var | | 9.426641 |
| Adjusted R-squared | .940000 | S.D. dependent var | | 8.054797 |
| S.E. of regression | 2.26E-14 | Sum squared resid | | 3.58E-27 |
| F-statistic | 5.71E+29 | Durbin-Watson stat | | 1.915311 |
| Prob (F-statistic) | 0.001 | | | |

Table 2 shows the effects of PPT rate on the profitability of oil and gas industries and shareholders' wealth. A 1% increase in the petroleum profit tax (PPT) reduces profitability of oil and gas firms in Nigeria by 17 percent and in turn results into negative reduction of 4.8% in shareholders wealth which will ultimately reduced dividend distributed to shareholders by same percentage.

Given the adjusted R significant of 95%, it presages the independence variables incorporated into this model have been able to determine variation of PPT fully, profitability and shareholders' wealth.

Hypotheses testing

H₀₁: Petroleum profit tax rate does not have significant effect on profitability of oil and gas industries.

In line with table 2, The F and probability statistics also confirmed the significance of this model which revealed that PPT rate has a significant effect on the profitability of oil and gas firms in Nigeria (**F = 5.71, R² = 1, Durbin Watson 1.91, P = 0.000 < 0.05**).

H₀₂: Petroleum profit tax rate does not have significant effect on shareholders' wealth.

Table 2 further revealed that at 0.05 level of significant, Petroleum profit tax have significant effect on shareholders' wealth of oil and gas industries ($p = 0.034 < 0.05$).

Summary and conclusions

PPT has a negative effect on profitability of oil and gas industries. All the variables are statistically significant. Estimated results revealed that every 1% increase in PPT will cause a decrease in profitability and shareholders' wealth of oil and gas firms. Though huge revenue earned by the government through the PPT helps government to fund public expenditure that stimulates the national economy, but consideration should likewise be given to the payer of such tax

Policy recommendations

Based on the findings made in the course of this study, the following recommendations are hereby suggested: Government should reduce tax rate payable by oil and gas firms in Nigeria at least by 30 to 35% to enable these firms grow and increase the wealth of shareholders. It is recommended that Government should transparently and judiciously account for the revenue it generates through PPT by investing in the provision of infrastructure and public goods and services. It is expected that the more effectively and efficiently revenue is utilized by Government to create growth, employment opportunities and wealth in the economy, the more willing taxpayers would be to meet their obligations to the Government and discharge their duties in the overriding goal of achieving National Development.

References

- Adekanola, O. (2007). "Taxation as a Means of Economic Revitalization: Limitations and Prospects in a Developing Economy", Lagos, The Nigerian Institute of Chartered Accountants of Nigeria-The Nigerian Accountant, Volume 40.No. 4
- Anyanwu, J.C. (1993). Monetary Economics: Theory, Policy and Institutions, Onitsha: Hybrid Publishers.
- Appah E & Ebiringa, O.T (2012). Petroleum Profit Tax and Profitability of oil and gas firms in Nigeria in Nigeria. International Journal of Management Sciences and Business Research Volume 1, Issue 9 2012 pp 12- 22.
- Attama .N. (2004), Taxation and Fiscal Policy, Enugu, Nigmos Publishers
- Azaiki, S. and Shagari, S. (2007). Oil, Gas and Life in Nigeria, Ibadan: Y-Books, a division of Associated Books Makers of Nigeria.
- Bawa, S. and J.A. Mohammed, 2007. Natural Resources Abundance and Profitability of oil and gas firms in Nigeria in Nigeria. Cent. Bank Niger. Econ. Rev., 45(3).
- Gallun, A.R. and J.W. Stevenson, 1986. Fundamentals of Oil and Gas Accounting. 2nd Edn., Penn Well Publishing Industries, Tulsa.
- Kjell L and Petter O (2011) Petroleum taxation: Experience and issues
- Nafziger, E.W. and J. Auvinen, 2003. Economic Development, Inequality and War: Humanitarian Emergencies in Developing Countries. Palgrave Macmillan, Hound Mills.
- Nwadighoha, C.E. (2007). Oil and Gas Accounting, Enugu: Ephraimites Printing and Publishing LTD.
- Nwete,B.O.(2004), "How can Tax Allowances Promote Investment in Nigerian Petroleum Industry" bonlaw@ ya hoo.co.uk
- Nwezeaku, N.C. (2005). Taxation in Nigeria: Principles and Practice, Owerri: Springfield Publishers Limited.
- Nwezeaku, N.C., (2015). The effect of public sector financial management on the economies of sub-Saharan Africa. Int. J. Finance Econ., 40: 87-99.
- Odularu, G.O., (2008). Crude Oil and Profitability of oil and gas firms in Nigeria. Retrieved from: <http://www.og us.ru/eng>.
- Odusola, A. (2006). "Tax policy reforms in Nigeria", World Institute for Development Economics and Research, Research Paper No. 2006/03. <http://www.wider.unu.edu>
- Ofe I.I., Onyemachi J.O. and Caroline A.A.(2008), Taxation 1 Course Development.
- Ogbonna, G. N. (2009) "Burning Issues and Challenges of the Nigerian Tax Systems with Analytical Emphasis on Petroleum Profits Tax". International Journal of Accounting, Finance, & Economics Perspectives, 1(1) FALL, 2009.
- Ogbonna, G.O. (2011). "Petroleum revenue and the economy of Nigeria", Ph.D. Dissertation, Department of Accounting, University of Port Harcourt, Nigeria.
- Ogbonna G.N, and Appah E (2012), Effect of Petroleum Revenue and the Economy of Nigeria. Current Research Journal of Economic Theory 4(2): 11-17, 2012.